



ORIGINAL



0000120870

RESIDENTIAL UTILITY CONSUMER OFFICE

1110 WEST WASHINGTON STREET • SUITE 220 • PHOENIX, ARIZONA 85007 • (602) 364-4835 • FAX: (602) 364-4846

Janice K. Brewer  
Governor

Jodi A. Jerich  
Director

Arizona Corporation Commission

DOCKETED

DEC 17 2010

DOCKETED BY

ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

2010 DEC 17 A 10:18

RECEIVED

December 17, 2010

Commissioner Sandra D. Kennedy  
Arizona Corporation Commission  
1200 W. Washington  
Phoenix, Arizona 85007

Re: **Docket No. ACC-00000A-10-0466**  
**Interim Rates – Response to Commissioner Kennedy's Letter**

Dear Commissioner Kennedy:

RUCO analyzed the possibility of implementing non-emergency interim rates in Arizona. Our conclusions are detailed below and supported by the attached legal memorandum.

In summary:

1. Interim rates are an appropriate mechanism to combat regulatory lag.
2. *Scates, Rio Rico and Pueblo del Sol* establish clear legal precedent that – ***absent a finding of fair value*** – interim rates are only permitted in an emergency or through an adjustor clause.<sup>1</sup>
3. Absent an emergency or an adjustor, interim rates are permissible as long as the Commission (a) makes a meaningful fair value finding, (b) interim rates are subject to a refund plus interest, and (c) minimum due process rights are satisfied for all parties to the rate case.

<sup>1</sup> For additional background, Chief ALJ Farmer provides a legal analysis of interim rates in the Recommended Order and Opinion in the APS Interim Rate Case, Docket No. E-01345A-08-0172, pp. 31-33.

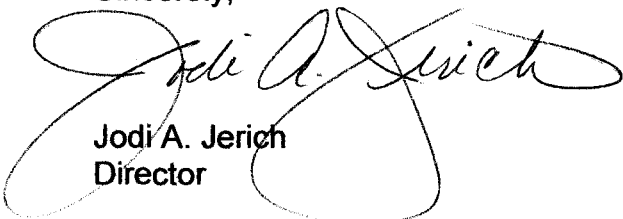
Commissioner Sandra D. Kennedy  
December 17, 2010  
Page 2

4. Since non-emergency interim rates demand a fair value finding, RUCO believes that setting interim rates based upon a percentage of the requested increase is arbitrary and the interim rates are not predicated on a meaningful fair value finding.
5. The constitutional requirements of a fair value finding and due process rights do not allow for interim rates to go into effect immediately upon the filing and/or sufficiency finding of a rate application.
6. RUCO believes ARS §40-367 is unconstitutional. It is an impermissible usurpation of plenary and exclusive Commission authority.
7. A.A.C. R14-2-103(b)(11)(h) needs to be supplemented in order to clearly describe the Commission's procedures for non-emergency interim rates.

I am not persuaded by arguments that an interim rate increase creates a premature rate hike on ratepayers. I surveyed my fellow consumer advocates in other states on this issue. Where interim rates are regularly implemented, my peers had little or no consternation over its use. I agree with these colleagues that interim rates allow for **timely** recovery for investments already made. These states utilize carefully crafted, detailed procedures for implementing interim rates that provide a clear and predictable guide for interim rate increases. Additionally, commissions exercising interim rates always include a "refund with interest" safeguard. Arizona should follow a similar course and issue a Notice of Proposed Rulemaking to expand and clarify its interim rate Rule.

I think this is a provocative issue and you will have many diverse responses to your letter. If it is the desire of the Commission to institute interim rates, RUCO looks forward to working with the Commission to craft a Rule that puts in place interim rates in a legal manner. I am available to discuss my comments further at your convenience.

Sincerely,



Jodi A. Jerich  
Director

cc: Docket Control



## RESIDENTIAL UTILITY CONSUMER OFFICE

1110 WEST WASHINGTON STREET • SUITE 220 • PHOENIX, ARIZONA 85007 • (602) 364-4835 • FAX: (602) 364-4846

Janice K. Brewer  
Governor

Jodi A. Jerich  
Director

TO: Jodi Jerich, Director

FROM: Michelle Wood, Counsel

DATE: December 16, 2010

RE: IN THE MATTER OF THE ARIZONA CORPORATION COMMISSION'S  
REVIEW OF THE COMMISSION'S GENERAL RATE CASE  
PROCESSES AND PRACTICES. Docket No. ACC-00000A-10-0466

The Commission has opened the above-referenced docket to examine how the Commission process can be streamlined or modified through the granting of interim rates in an effort to address regulatory lag. The docket identifies four potential alternatives for granting "interim rates" and asks stakeholders to comment on the four options.<sup>1</sup>

**A. Absent the finding of an emergency, the granting of rates must be predicated on fair value.**

The first step in this inquiry should be to examine the legal parameters under which "interim rates" may be granted. The Commission's ratemaking authority is plenary and exclusive, but it is not without limitation.<sup>2</sup> Although the Commission has broad discretion in establishing rates, with limited exceptions, it is required by our Constitution to ascertain the fair value of a utility's property within the State in setting just and reasonable rates.<sup>3</sup> In Residential Utility Consumer Office v. Ariz. Corp. Comm'n, RUCO appealed from the Commission's grant of Rio Verde Water Co.'s request for a surcharge to collect increased costs it was paying to the Central Arizona

<sup>1</sup> Commissioner Kennedy, in a letter dated November 18, 2010, requested stakeholders respond to four different proposals aimed at addressing perceived regulatory lag.

<sup>2</sup> Ariz. Const. Art 15§3; Arizona Corp. Comm'n v. State ex rel. Woods, 171 Ariz. 286, 830 P. 2d 807 (Ariz. 1992); State v. Tucson elec. Light and Power Co., 15 Ariz. 294, 138 P. 781 (Ariz. 1914).

<sup>3</sup> Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P. 2d 612 (App. 1978) ("Scates").

Project for water.<sup>4</sup> The surcharge was imposed without a fair value proceeding. *Id.* RUCO asserted that the surcharge was an interim rate, which must be predicated on the finding of an emergency and with appropriate due process. *Id.* The Commission asserted that its power was plenary and exclusive and its ability to impose interim rates was not limited to emergency situations. *Id.* at 592.

The Court reaffirmed that the Arizona Constitution requires that the Commission only change a utility's rates in conjunction with making a finding of the fair value of the utility's property.<sup>5</sup> However, the Court recognized that, "in limited circumstances," the Commission may engage in rate making without ascertaining a utility's rate base. Those limited circumstances include adjustors based on an adjustor mechanism previously established in a fair value proceeding, or by the establishment of interim rates when an emergency exists.<sup>6</sup> The Court stated that an award of interim rates must be predicated on the finding of an emergency; the posting of a bond guaranteeing refund if interim rates are higher than final rates determined by the Commission; and a true-up based on a fair value proceeding.<sup>7</sup> The Court found that an emergency exists when "sudden change brings hardship to a company, when a company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt."<sup>8</sup> The Court further emphasized that the deterioration of a company's financial position due to regulatory lag, is not an emergency. *Id.*

Absent a demonstrable emergency, rates must be predicated on a fair value proceeding. If the Commission determines that an emergency exists, interim rates may only be imposed upon the posting of a bond and a true-up of the interim rates in a fair value proceeding.

#### **B. Rates must be established in compliance with due process.**

In RUCO, the Commission also argued that its grant of a surcharge could be characterized as an automatic adjustment which could be established without a full rate case. The Court, citing again to the Scates decision, held that:

"the Commission's position not only offends the Scates court's concerns about piecemeal rate making, but it also offends the constitutional mandate that rates be fair and reasonable and made in the context of a fair valuation of all of the

---

<sup>4</sup> Residential Utility Consumer Office v. Ariz. Corp. Comm'n, 199 Ariz. 588, 20 P.3d 1169 (Ct. App. 2001) ("RUCO").

<sup>5</sup> RUCO at 199 Ariz. at 592, 20 P.3d at 1173. See also A.R.S. Const. Art. XV, § 14; Simms v. Round Valley Light & Power Company, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956); see also State v. Tucson Gas, 15 Ariz. 294, 308; 138 P.781, 786 (1914); Arizona Corporation Commission v. State ex rel. Woods, 171 Ariz. 286, 295, 830 P.2d 807, 816 (1992).

<sup>6</sup> Residential Utility Consumer Office v. Arizona Corporation Commission, 199 Ariz. 588, 591 ¶11, 20 P.3d 1169, 1172 (App. 2001).

<sup>7</sup> *Id.* at 591; See also Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P. 2d 612 (App. 1978) ("Scates").

<sup>8</sup> RUCO at 591 citing to Op. Atty. Gen. 71-17 at 13 (1971).

utility's assets (citations omitted). If ever there was a situation "fraught with potential abuse" (citations omitted), it occurs when the Commission of its own volition has the ability to declare any rate increase an "automatic adjustment"....at the very least, a mode of establishing an automatic adjustment clause must meet minimum standards of due process.... Having the ability to characterize a surcharge as an automatic adjustment without prior approval fails to meet those minimum standards of due process."<sup>9</sup>

Elaborating further on the issue of due process, the Court held:

A public utility is entitled to due process when a ratemaking body undertakes to calculate a reasonable return for the use of its property and services by the public (citations omitted). Conversely, the public is entitled to the same level of protection when the government seeks to increase the utility rates that the public is obligated to pay.

Id. The Commission's determination of rates must include due process for the public.

Option 1 permits a Company to seek interim rates under the existing rule A.A.C. R14-2-103 (B)(11)(h). The Commission's Rule does not specify that the finding of an emergency is necessary before the granting of interim rates. RUCO questions the validity of the Rule based on the legal analysis set forth above. At the very least, the Rule should be modified to comply with the law as interpreted by the Court of Appeals in RUCO.

Option 2 contemplates an award of interim rates based on a formula at the end of a utility's substantive review time frame, if the Commission has not yet issued a decision on permanent rates. Option 2 allows for the imposition of interim rates at the close of the sufficiency period. All parties are permitted to participate in the evidentiary hearing process. If the Commission had concluded its evidentiary proceeding within 360 days, the due process requirement of RUCO and Scates would be satisfied. However, the determination of interim rates must be based on a meaningful fair value finding. Absent an emergency, the Commission's decision would have to be based on fair value.

Option 3 contemplates an award of interim rates based on a Staff Report or Staff testimony at the end of the substantive review time frame, if the Commission has not yet issued a decision on permanent rates. To the extent that Option 3 relies solely on Staff testimony or a Staff report and precludes the involvement of RUCO and other intervenors, Option 3 would not provide adequate due process as required by the RUCO and Scates decisions. And of course, interim rates would have to be based on a meaningful fair value finding barring an emergency.

Option 4 contemplates an award of interim rates based on a formula at the commencement of the sufficiency period, subject to refund upon granting permanent rates. Absent an emergency, the imposition of rates must be predicated upon fair

---

<sup>9</sup> Id. at 592-593, citing Scates, 118 Ariz. at 535, 578P.2d at 616.

value. This requirement would preclude consideration of Option 4 because sufficiency typically occurs within 30 days of an application. It would be virtually impossible for the Commission to conduct a due process proceeding in 30 days of receiving an application to determine whether a utility has an emergency necessitating interim rate or to determine the utility's fair value. Accordingly, Option 4 is not an appropriate alternative.

**C. Have utilities suffered delays not contemplated by the rules?**

The Commission's rules contemplate that a Class A or B utility rate application will be heard within 180 days of sufficiency and decided within 360 days of sufficiency unless: 1.) the utility submits more than one rate application to the Commission at the same time, 2.) the utility amends its filing or 3.) there is an extraordinary event, not otherwise provided for by the rules.<sup>10</sup> In the event of an exception to the substantive time frame, the Commission may restart or extend the time clock.<sup>11</sup>

For the purposes of this docket, RUCO has reviewed the cases in which it has participated. Although the hearing schedules in these matters substantially complied with the Commission's existing rules, in some instances, the ultimate decisions were not issued within the substantive time frames. Although the Commission issued some decisions after the standard time frames established by the rules, those decisions involved more than one case and intervening matters. As a practical matter, multi-system applications may require more time than single-system applications. Accordingly, the rules recognize that the handling of multiple matters for the same utility will elongate the standard substantive review time periods. *Id.* There may be some benefit to combining rate applications for several systems for all parties. However, if utilities submit multi-system applications, these applications will not be handled as expeditiously as an application with one system. In recognition of the fact that many utilities file multi-system rate applications, the Commission should not automatically assume that its inability to meet substantive time frames in these cases necessitates an award of interim rates. Delay in processing multi-system rate applications is contemplated by the rules, and such delay may not necessitate an award of interim rates.

---

<sup>10</sup> See A.A.C. R14-2-103 (B)(11).

<sup>11</sup> See A.A.C. R14-2-103(B)(11)(d) and (g).